No. 9817

# In the United States
# Circuit Court of Appeals
## For the Ninth Circuit

ISIDORE WINKLEMAN, alleged bankrupt,
*Appellant,*

vs.

T. OGAMI, MESAL BAG COMPANY, Portland Bag and Metal Company and Enke's City Dye Works, Inc.,
*Appellees.*

## APPELLEES' BRIEF

Upon Appeal from the District Court of the United States, for the District of Oregon.



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## APPELLEES' BRIEF

Upon Appeal from the District Court of the United States, for the District of Oregon.

## OPENING STATEMENT

This case is before the court upon an agreed statement of the case which is set forth in the transcript of record. It is for the decision of this court whether the lower court erred in refusing to consider as an issue at the hearing on the involuntary petition in bankruptcy filed by the appellees whether or not any of the petitioning creditors had received preferences and refused to surrender them.

The appellant attempted to make an issue out of certain alleged preferences claimed to have been received by the petitioning creditors, and contended it was for the lower court to determine whether such preferences had been received or not, and if so, such petitioning creditors would be disqualified if they refused to surrender or offer to surrender such alleged preferences.

It is admitted that the alleged bankrupt had more than twelve creditors at the time of the filing of the involuntary petition in bankruptcy, and three qualified creditors were required to support the petition for an order of adjudication. The lower court held that under the law, no issue could be made as to the qualification of such three creditors on the question as to whether or not they had received preferences and failed or refused to surrender them. This appeal raises a question which, in the belief of the writer, is squarely before an appellate court for the first time.

## POINTS AND AUTHORITIES

THE ONLY QUALIFICATIONS OF A PETITIONING CREDITOR ARE THAT HE SHALL HAVE A PROVABLE CLAIM FIXED AS TO LIABILITY AND LIQUIDATED AS TO AMOUNT.

Sec. 59 (b) Bankruptcy Act, as amended (11 U.S.C.A. § 95).

In re Hornstein, 122 Fed. 266, 10 Am. B. R. 308.

## ARGUMENT

The appellant has not cited any statutory authority setting forth any greater qualifications that must be met by a petitioning creditor, other than as set forth in Section 59 (b) of the Bankruptcy Act, supra.

The sole qualifications of the petitioning creditor are set out in that subsection of the Bankruptcy Act, and no provision of the Act expressly disqualifies a petitioning creditor merely because he may have received a voidable preference. The petitioning creditor carries the burden of establishing he holds a provable claim under the Bankruptcy Act, and this does not necessarily mean an "allowable" claim.

A distinction must be recognized between the words "provable" and "allowable". A claim may be provable and not be allowable. If a petitioning creditor was required to prove that he had an allowable claim, then the question of surrendering a preference may be considered by the court in determining such creditor's qualifications.

It is the position of the appellants that the lower court was charged with the duty to determine whether or not the claim was both provable and allowable. A very interesting discussion of the distinction between a provable claim and allowable claim is found in the case of In re Hornstein, 122 Fed. 266, in which the court determined that a prov-

able claim was not necessarily an allowable claim and that it was not incumbent upon a petitioning creditor to establish an allowable claim in order to maintain an involuntary petition in bankruptcy.

A PETITIONING CREDITOR HAVING A VOIDABLE PREFERENCE MAY FILE OR JOIN IN AN INVOLUNTARY PETITION IN BANKRUPTCY.

Section 59, Bankruptcy Act, as amended (11 U.S.C.A. § 95).
In re Hornstein, 122 Fed. 266 (275), 10 Am. B. R. 308.
In re Macklem, 22 Fed. (2d) 426, 10 Am. B. R. (N.S.) 550.
Stevens v. Nave-M'Cord Mercantile Co., 150 Fed. 71, 17 Am. B. R. 609.

## ARGUMENT

It is admitted by the appellant, and supported by ample authority, that no petitioning creditor is disqualified to file or join in an involuntary petition in bankruptcy merely because he holds a voidable preference. The jurisdiction of the court over the proceedings in bankruptcy is established by the proper petition of such a creditor. The appellant contends that although the court has jurisdiction of the proceedings, no order of adjudication can be made until the petitioning creditor holding a preference has surrendered, or offered to surrender, such preference. No provision of the Bankruptcy Act, as amended, expressly terminates the jurisdiction of

the bankruptcy court to enter an order of adjudication upon failure of the petitioning creditor to surrender his preference.

A CREDITOR RECEIVING A PREFERENCE CAN QUALIFY AS ONE OF THE NECESSARY PETITIONING CREDITORS IN AN INVOLUNTARY PETITION IN BANKRUPTCY WITHOUT SURRENDERING, OR OFFERING TO SURRENDER, AN ALLEGED VOIDABLE PREFERENCE.

> In re Automatic Typewriter & Serv. Co., 271 Fed. 1 (Circuit Court of Appeals, 2nd Circuit, 1921).

A search of the authorities on the above point indicates that the question involved in this appeal is helped very little by existing precedents. The only case decided in an appellate court that sheds any light on this point is the case of In re Automatic Typewriter & Serv. Co., supra. In this case, the Circuit Court of Appeals refused to reverse the Federal District Court for the Southern District of New York when it upheld an involuntary petition in bankruptcy filed by a petitioning creditor holding an attachment lien against the bankrupt's property. The bankrupt had contended in its answer that the petitioning creditor had received a preferential payment on account of the attachment and therefore such creditor was disqualified to maintain its petition. The court said:

> "Furthermore, the preferred creditor who files a claim may surrender his preference at any time before the claim is allowed. This he need not do before the filing of the claim. We think the court below committed no error in refusing to dismiss the petition in bankruptcy because of this." (p. 4)

Although the above case involving an attachment lien is not precisely in point with the instant case, where the preference is based upon an alleged payment to the creditor, still the reason in both situations for not dismissing the petition on account of the alleged preference, is present. No advantage is held by a petitioning creditor holding a preferential payment over other creditors. The mere joining in the petition gives him no further rights. He should not be required to surrender, or offer to surrender, an alleged preference before adjudication when he may honestly believe he holds no preferential payment, and since the decree of adjudication in involuntary bankruptcy is not res adjudicata as to the amount or validity of the claims of petitioning creditors when subsequently presented for allowance.

> In re Continental Engine Co. (C.C.A.), 234 F. 58.
> In re Harper (D.C.N.Y.), 175 F. 412.
> Remington on Bankruptcy (4th ed.) Secs. 530 and 966.

One of the main purposes of the bankruptcy laws is to protect creditors against losses through preferential transfers. The filing of involuntary peti-

tions in bankruptcy is the method by which the creditors bring the debtor under the jurisdiction of the bankruptcy court to avoid such preferential transfers. A preferred creditor should be no less qualified by reason of his preference than any other creditor when he requests the court to adjudicate the debtor a bankrupt.

A creditor receiving a preference can have no advantage, and seeks no advantage, when he joins with other petitioning creditors to have the bankrupt's property subjected to the jurisdiction of the Bankruptcy Court. In fact, by joining in the petition, he has done the very thing that may bring about the subsequent surrender of any preference that he may hold. If he did not join in the petition no adjudication may ever take place, and the preference he holds would be retained by him without any right on the part of other creditors to demand a surrender thereof.

By joining in the petition, the petitioning creditor alleged to have received a preference, has willingly and voluntarily submitted himself to the jurisdiction of the court and thereby puts the machinery in motion whereby his claim may be subsequently affected by failure to surrender a preference, found to be such, at the time of the allowance of his claim.

Considerable has been said in appellant's brief relative to the rights of a preferred creditor, insofar as participating in the benefits of all the bankruptcy proceedings, until he has surrendered his

preferences. The appellant contends that a petitioning creditor must surrender, or offer to surrender, his preference, before he may be counted as a petitioning creditor, and cites Section 59 (b) of the Bankruptcy Act, as amended. Sub-section (5) of the last quoted section in no way helps to solve the question before this court, as that sub-section as explained by sub-section (e) only provides that creditors who have received preferences under the Act are not to be counted among the *total number of creditors* in determining whether there are more than eleven creditors necessitating the joining of three petitioning creditors to maintain an involuntary petition in bankruptcy.

Appellant cites a number of cases which deal only with the principle that creditors who have received a preference are not to be considered either for or against the petition in arriving at the total number of existing creditors as the basis for fixing the number of creditors that necessarily must join in the involuntary petition.

The principal cases cited by appellant in support of his contention are cases decided in the Federal District Courts, and it is only by careful analysis and consideration of these cases that one can recognize the error of the appellant in citing such cases as authority on the point involved.

The first case found, that in any way touches the point on review, is the case of

In re Gillette, 104 Fed. 769 (1900)

decided by the Western District Court of New York in 1900, wherein the petitioning creditor was also a judgment creditor and had received a certain preferential payment, and the court there refused to enter an order of adjudication until the petitioning judgment creditor had paid into the Clerk of the Court the amount of the preference. In arriving at the propriety of such a decision, the court did not predicate its decision upon any definite authority nor set forth any sound reason for requiring the preferred creditor to surrender his preference.

After this case followed:

In re Hornstein (1903), supra,

cited by the appellant. This was another District Court case which involved an attachment lien held by one of the petitioning creditors, and the court there approved the court's decision in: In re Gillette, and required the petitioning creditor to surrender the attachment lien before the order of adjudication could be entered. In this case the court failed to recognize that an order of adjudication would have resulted in a discharge of the attachment lien in the manner set forth in the case of In re Automatic Typewriter & Service Co., supra.

It is interesting to note that in the Hornstein case, the court said (p. 276):

> "Again, the attachment of these petitioners is not four months old, and hence will fall on an adjudication in bankruptcy."

In deciding that the preferred creditor could properly join as a petitioning creditor, the court, in the Hornstein case said further (p. 276):

> "Until the claim is 'proved' the court is powerless to 'allow' it, and until allowance is under consideration the question whether or not 'a preference' has been received cannot be determined by the court."

The court in that case pointed out the principal question before the court was whether the petitioner had a right to file a petition, and the holding that the attachment lien must be surrendered was purely obiter dictum by the court.

Following the Hornstein case, came the case of—

> In re Fishblate Clothing Co., 125 Fed. 986 (1903)

another District Court case cited by the appellant. There, the court, without citing any authority, merely made a finding that the petitioning creditor had received a preference which he would not voluntarily surrender, and therefore was disqualified from maintaining the petition. The petition was dismissed for other reasons besides the disqualification of the petitioner.

The next case, which is Stevens v. Nave McCord (1906), supra, decided in the Circuit Court of Appeals for the Eighth Circuit, and cited by appellant, is not truly decisive on the question involved in this appeal. The principal question before the court for decision was whether or not the preferred creditors

were to be counted in determining whether one or three creditors were required to maintain the petition, and there the court decided that creditors who received a voidable preference were not to be computed in determining how many must join in the petition, and it is important to note that the court expressly stated it was not deciding whether two of the petitioning creditors had a right to join with a third in a petition for adjudication. However, there is some dicta by the court in this case, appearing on page 76 of the reported case, that the petitioning creditor cannot be counted for the petition unless he surrenders his preference before the adjudication, citing: In re Hornstein, supra, and: In re Gillette, supra.

However, in this case it cannot be said any rule was established by this dicta as the court was principally concerned with the question as to the number of petitioning creditors required to support a petition in bankruptcy calculated upon the total number of creditors.

In the Matter of John F. Murphy, 225 Fed. 392 (1915), which is a District Court case cited by the appellant, should not be considered as an authority for the position taken by the appellant. The court simply took the dicta from the Stevens case without setting forth any reasons of its own and held that the preferential payment must be returned by depositing the same with the Clerk of the Court before an order of adjudication would be made.

The next case is: In re Standard-Detroit Tractor Co. (1921) 275 Fed. 952, 47 Am. B. R. 642, another District Court case, cited by appellant, which did not have before it the point in issue in this appeal, as it was conceded by the petitioning creditor that if he received a voidable preference he could not maintain his petition without surrendering, or offering to surrender, his preference before adjudication. Therein, the court said (p. 954):

> "It is therefore unnecessary to consider the question whether such a creditor may file such a petition without making a surrender of any voidable preference, previously obtained, a question which, in view of the distinction between the proving and the allowance of a claim in bankruptcy, and the consequent difference between the meaning of the terms 'provable' and 'allowable' is not free from difficulty, and cannot, in my opinion, be regarded as authoritatively decided."

Appellant next cites the case of: In re Cooper, 12 Fed. (2d) 485 (1926), which is another District Court case that merely decides that creditors who have received a preference are not to be counted in determining the number of creditors that must join in the petition in bankruptcy.

Next follows the case of In re Macklem, 22 Fed. (2d) 426, (1927), another District Court case cited by appellant. In this case, without supporting its views with any reasons, the court held the weight of authority is that a creditor who has received a voidable preference may not be counted as one of

the three required petitioning creditors, unless he surrenders his preference, citing the Stevens case, supra, In re Gillette, supra, In re Cooper, supra, Canute S. S. Co. v. Pittsburg Coal Co., 263 U.S. 244, 2 Am. B. R. (N.S.) 231, and In re Hornstein, supra. It cannot be said from an examination of such authorities cited that the decision In re Macklem, supra, is accurate precedent for the proposition contended for by the appellant.

The case of In re Phillips & Co., Inc., 28 Fed. (2d) 299 (1928), cited by the appellant, is a District Court case in which the court assumed the law to be as contended by the appellant, without citing any authority, and it does not appear that the decision in the case involved the question as to whether or not the petitioning creditors were qualified by reason of having received a preference.

The appellant cites the case of Brehme v. Watson, 67 Fed. (2d) 359, which is a case decided in the Circuit Court of Appeals for the Ninth Circuit, which did not have before it for decision the question involved in this appeal.

There is also cited the Supreme Court case of Canute Steamship Co. v. Pittsburg, etc., supra, which in no respect decided the question of law before this court.

A full consideration of the cases and authorities touching the points at issue can only lead to the conclusion that the District Courts have been con-

fused and misled by the early decisions of In re Gillette and In re Hornstein. And the dicta in the Stevens case further led the lower courts into deciding, without supporting reasons, that a petitioning creditor cannot secure an order of adjudication unless he surrenders any preference he may hold.

The question as to whether the jurisdiction of the bankrupt court was affected by the subsequent payment by the bankrupt of one of the petitioning creditors, was considered by the Circuit Court of Appeals of this Circuit in the case of Reed v. Thornton, 43 Fed. (2d) 813. Therein Judge Wilbur held that the jurisdiction of the court attached from the filing of a petition filed by three creditors, and that a subsequent payment by the bankrupt of some of the creditors could not deprive the court of jurisdiction.

It appears that if the acceptance of a preferential payment by a petitioning creditor after the filing of a petition did not affect the jurisdiction of the court, then the acceptance of a preferential payment by the petitioning creditor within four months prior to the filing of the petition would not deprive the court of jurisdiction to enter an order of adjudication by reason of any disqualifcation of such petitioning creditor.

## CONCLUSION

A determination of the question before the court necessarily calls for some consideration of the effect of the Chandler Act upon the law of bankruptcy insofar as that act was adopted in 1938 for the purpose of clarifying certain provisions of the old bankruptcy act and eliminating the confusion of conflicting decisions, language ambiguities, etc.

The contentions of the appellant that the lower court was required to determine whether or not the three creditors were qualified on account of having received alleged preferences is not supported in any respect by any express statutory provisions of the Chandler Act.

A rule grew up under the decisions of the various courts that in computing whether one or three creditors are required to join in an involuntary petition in bankruptcy, the creditors holding preferences were not to be counted in arriving at the number required to join in the petition. This rule was firmly established by the courts and was based upon sound reasoning and good logic, and for the purpose of clarifying the bankruptcy law and making statutory that which had become law by "stare decisis", the Chandler Act added to Section 59 of the old bankruptcy act a specific provision eliminating creditors who had received voidable preferences under the Act from the total number of creditors to be counted in determining the number of creditors that must join in the petition.

It was out of the decisions establishing the foregoing rule that some of the courts recited the rule that is now being urged by the appellant as the law deciding the question of law in this appeal. However, it is interesting to note that the Chandler Act did not go so far as to set down by statute an express provision disqualifying a petitioning creditor holding a voidable preference which was not surrendered or offered to be surrendered prior to adjudication. It is reasonable to expect that if such was the law established by the decisions and if it was founded upon sound purpose, then the bankruptcy act would have been amended accordingly. For the one there is a reason, for the other there is none.

A decision in favor of the appellant herein will necessarily require this court to make some interpretation of the Bankruptcy Act based upon a good reason that a petitioning creditor holding a voidable preference is disqualified unless he surrenders his preference or offers to do so.

A petitioning creditor who holds a voidable preference holds no advantage over other creditors in law by failing to surrender or refusing to surrender his preference. Upon the entry of an order of adjudication the trustee may recover such preferences as may have been received by the creditor, and his claim will not be allowed until he surrenders his preference, and the rights of all creditors are fully protected and it would be a vain and useless thing

for the creditor alleged to be holding a voidable preference to require him to do that which the law requires him to do in order to preserve the jurisdiction of the court over the proceedings in bankruptcy.

The Circuit Court of Appeals has already recognized that the bankruptcy court is not ousted of jurisdiction when it is shown that a sole petitioning creditor is also holding an attachment lien acquired within four months of the filing of the petition.

> In re Automatic Typewriter & Service Co., supra.

The order of adjudication in such a case terminates the attachment lien and fixes the rights of the respective creditors to share in the property held as a preference. The identical rights are conferred upon the trustee to recover the property after an order of adjudication in those cases where a preferential payment has been received by one of the petitioning creditors.

It is respectfully submitted that neither the bankruptcy act as amended nor the decisions of the courts required that the lower court determine whether or not the petitioning creditors had received preference before entering an order of adjudication.

Respectfully submitted,

WILLIS WEST,
Attorney for Appellees.